



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended: **04/28/05**

Bill No: **AB 1613**

Tax: **Sales and Use**

Author: **Klehs**

Related Bills:

BILL SUMMARY

This bill would provide that a construction contractor is the consumer of, and shall not be considered a retailer of, a solar energy system, as defined, furnished and installed in the performance of a construction contract for the improvement to realty.

Summary of Amendments

The introduced version of this measure declared the intent of the Legislature that, in the case of a business that has a warehouse located in this state, if that warehouse is the only place of business in this state that participates in a sales transaction, that the place of business for purposes of allocating local tax shall be deemed to be the location of the warehouse.

ANALYSIS

Current Law

Under California's Sales and Use Tax Law, every person desiring to engage in or conduct business as a seller of tangible personal property within this state is required to apply to the Board for a seller's permit for each place of business. In general, a seller's permit must be obtained if a person intends to sell or lease tangible personal property that would ordinarily be subject to sales tax if sold at retail.

The Board's Regulation 1521, *Construction Contractors*, provides specific guidelines on a contractor's responsibilities under the Sales and Use Tax Law. Construction contractors are persons who erect, construct, alter, or repair any building or other structure, project, development, or other improvement on or to real property. In general, construction contractors are the consumers of the materials and retailers of the fixtures they furnish and install in the performance of a construction contract. As consumers, contractors are generally required to pay tax on their cost of the materials used in the course of the project. With respect to fixtures, contractors are regarded as retailers, and tax applies to their sales of the fixtures.

"Materials" means construction materials and components, and other tangible personal property incorporated into, attached to, or affixed to, real property by contractors in the performance of a construction contract and which, when combined with other tangible personal property, loses its identity to become an integral and inseparable part of the real property. Typical items regarded as materials include asphalt, linoleum, steel, bricks, cement, wallboard, and insulation.

"Fixtures" means items that are accessories to a building or other structure and do not lose their identity as accessories when installed. Items such as air conditioning units,

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lighting, burglar and fire alarms, cabinets, counters, elevators, electric generators, and plumbing hardware are typically regarded as fixtures.

Generally, a construction contractor who simply furnishes and installs materials is not required to obtain a seller's permit with the Board. Contractors that are generally regarded as consumers include, among others, concrete, asphalt or linoleum layers, painters, wallpaper hangers, and window installers. These contractors are generally regarded as consumers of the materials they purchase, and their tax liability is limited to the tax on their purchase price of the materials used in the performance of the contract.

With regard to a construction contractor that installs fixtures, the contractor's responsibilities are different. A contractor engaged in the business of furnishing and installing fixtures, such as solar panel systems or solar water heaters, is required to hold a seller's permit, file sales and use tax returns, and remit tax based on his or her selling price of the fixtures he or she installs. The Board's regulation provides that if the contract states the sale price of the fixture, tax applies to that price. However, if the contract does not state the sale price, such as in the case of a lump sum contract, the regulation provides that the sale price shall be deemed to be the contractor's cost price of the fixture.

Proposed Law

This bill would add Section 6018.9 to the Sales and Use Tax Law to provide that a construction contractor is the consumer of, and shall not be considered a retailer of, a solar energy system, as defined, furnished and installed in the performance of a construction contract for the improvement to realty.

The bill would define "solar energy system" as any solar collector or other solar energy device the primary purpose of which is to provide for the collection, storage, and distribution of solar energy for space heating, space cooling, electric generation, or water heating and that is certified by the State Energy Resources Conservation and Development Commission.

The provisions of this bill would become effective immediately, but would become operative on the first day of the first calendar quarter commencing more than 90 days after the bill becomes law.

COMMENTS

- 1. Sponsor and Purpose.** This bill is sponsored by the author. According to the author's office, it is intended to eliminate the confusion associated with a contractor's responsibilities to report tax on the installation of solar energy systems. The author's office notes that currently, construction contractors that furnish and install solar energy systems have a variety of reporting requirements under the Sales and Use Tax Law. Depending on the way the contractor reports the solar energy system on their invoices, the contractor is liable to report and remit sales or use tax based on either the contract price or the purchase price of the solar energy system. This causes confusion and enforcement issues as the contractor is often not registered with the Board of Equalization as a "retailer" – which they must be in order to properly report the tax when they furnish and install the solar energy system.
- 2. What is the effect of this measure?** Essentially, enactment of this measure would place construction contractors that furnish and install these solar energy systems in

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the same category as construction contractors that furnish and install materials. They would be regarded as consumers, and their tax liability would be limited to the tax on their cost price of the systems (which is actually the same amount of tax liability contractors have now when they bill on a lump sum basis). They would no longer be required to hold seller's permits, file sales or use tax returns, or remit tax to the Board on their sales price of the systems, regardless of whether their contracts provide for a separate sales price for the systems or are billed one lump sum price. Instead, provided the contractors pay all applicable tax on their purchase price of the items, they would have no further responsibilities to report tax to the Board.

3. **Bill sets a precedent.** Enactment of this measure would not materially affect the Board's administration of the Sales and Use Tax Law. However, it would set a precedent with regard to treating construction contractors of solar energy systems differently than contractors that furnish and install all other sorts of fixtures.

COST ESTIMATE

Some costs would be incurred in revising the Board's regulation, notifying affected contractors, and answering inquiries from taxpayers. We expect these administrative costs to be insignificant (less than \$10,000).

REVENUE ESTIMATE

Since 1999, the California Energy Commission's Renewable Energy Program has provided funding for approximately 12.3 thousand commercial and residential photovoltaic (PV) solar energy systems at a value of \$447.4 million, an average of \$74.6 million in completed projects per year. The Energy Commission funds approximately 2,046 PV systems that are installed throughout the State each year, at an average cost of \$36,500. In addition, the California Solar Energy Industries Association (CAL SEIA) estimates that approximately 600 solar water heating systems are installed in the state at an average cost of \$3,500, for a total of \$2.1 million (\$3,500 x 600). According to one contractor, solar water heating systems are generally sold as lump sum contracts.

By far, the PV system program is the largest solar system program in the state. To comply with the rebate program, the Energy Commission requires contractors to identify on their invoices the quantity, make, and model numbers of major equipment and the labor charge for installation. Major equipment makes up approximately 34% of the contract price; which includes a general mark-up of about 30%.

As with solar water heating systems, space heating and space cooling systems do not have the same contract requirements specifying the identification of cost of major equipment on invoices. For the purpose of this estimate, we will assume that all of these contracts are lump sum contracts where the contractor's sales and use tax liability is limited to his or her cost price. Therefore, there would not be any impact on these contracts with the enactment of this measure.

Using the information specific to PV solar electric generation systems, we determined the annual revenue loss associated with classifying contractors of solar energy systems as consumers, rather than retailers, is as follows:

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| Average annual number of completed projects | 2,046 |
| Average project cost | \$ 36,500 |
| Estimated value of major equipment in each project (34% of project cost) | 12,410 |
| Assuming an average markup of 30% | 2,860 |
| Total measure affected by this bill (2,046 x \$2,860) | 5,851,560 |
| State and local revenue loss | \$463,444 |

Revenue Summary

The annual revenue loss from extending new construction exclusion for active solar energy systems will be as follows:

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| State (5.25%) | \$307,000 |
| Local (2.0%) | 117,000 |
| District (0.67%) | <u>39,000</u> |
| Total | <u>\$463,000</u> |

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